**Internal Revenue Service**

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-100502-20

Date:
July 06, 2020

LEGEND

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

A =

B =

Agreement 1 =

Agreement 2 =

Agreement 3 =

Dear :

This letter responds to a letter dated December 12, 2019, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code (Code).

FACTS

The information submitted states X was organized on Date 1 as a limited liability company under the laws of State. A was the sole member of X.

Effective on Date 2, A signed an operating agreement, Agreement 1. Agreement 1 included provisions that created a second class of stock. Agreement 1 included the following provisions: (1) Section 7.1 providing, in part, "A Member which withdraws pursuant to Section 7.1 shall be entitled to a distribution in an amount equal to such Member's Capital Account; (2) Section 2.3, provided, "Individual capital accounts may be maintained for each Member consisting of that Member's Capital Contribution, (1) increased by that Member's share of profits, (2) decreased by that Member's share of losses and company expenses, (3) deceased by that Member's distributions, and (4) adjusted as required in accordance with applicable law.

On Date 3, A filed Form 2553, Election by a Small Business Corporation, for X to be treated as an S corporation. The provisions of Agreement 1 applied during the period when X intended to be treated as an S corporation until Date 4, when Agreement 2 replaced Agreement 1. At some point prior to Date 5, A transferred 50% of his interest in X to B. Effective on Date 4, A and B signed a new operating agreement, Agreement 2. Agreement 2 included provisions that created a second class of stock. Agreement 2 included the following provisions: (1) Section 9 provides, in part, that "After paying or providing for the payment of all Company debts, the proceeds of sale shall be distributed to the Members in accordance with their Capital Accounts." The term "Capital Account" was not defined in Agreement 2.

The provisions from Agreement 2 applied from Date 4, during the period when X intended to be treated as an S corporation, until Date 6. X represents that its S election on Date 3 was inadvertently invalid on Date 3 due to Agreement 1 creating a second class of stock and, if not inadvertently invalid, that its S election terminated on Date 4 due to the creation of a second class of stock.

X represents that the following corrective action was taken: on Date 6, A and B executed an amended and restated operating agreement for X, Agreement 3.

Agreement 3 included language that eliminated the issues relating to liquidating distributions being based on capital accounts.

X requests two rulings. First, due to the provisions of Agreement 1, X's S election was inadvertently invalid within the meaning of § 1362(f), and X will be treated as an S corporation from Date 3 and thereafter. Second, the termination of the X's S election due to the provisions of Agreement 2 was inadvertent within the meaning of § 1362(f), and X will be treated as an S corporation from Date 4 and thereafter.

X represents that the termination of its S election was inadvertent and was not motivated by tax avoidance or retroactive tax planning. X also represents that X and its shareholders agree to make any adjustments required as a condition of obtaining relief under the inadvertent invalid election rule as provided under §1362(f) of the Code that may be required by the Secretary. X and its shareholders represent that they have filed all returns consistent with X being an S corporation

LAW AND ANALYSIS

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2)), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1.1361-1(l)(1) provides, in part, that a corporation is generally treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state laws, and binding agreements relating to distribution and liquidation proceeds (collectively, governing provisions).

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the

corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) and the regulations thereunder provide relief for an ineffective S corporation election (i.e., treating the ineffective election as effective) or inadvertent termination of an S corporation election provided the following conditions are met: a. The corporation made an election under § 1362(a) that was ineffective or was terminated; b. The Service determines that circumstances resulting in the ineffectiveness or termination were inadvertent; c. Steps were taken by the corporation to qualify it as a small business corporation within a reasonable period of time after discovery of the ineffectiveness or termination event; and d. The corporation and all shareholders agree to any adjustments that the Service may require for the period.

CONCLUSION

Based on the facts submitted and representations made, we conclude that X's S election was inadvertently invalid on Date 3 because X had more than one class of stock due to provisions in Agreement 1. If X's S election was not inadvertently invalid on Date 3, X's S election would have terminated on Date 4 because X had more than one class of stock due provisions in Agreement 2.

We conclude that the termination of X's S election, as a result of Agreement 1 creating a second class of stock, was inadvertently invalid within the meaning of § 1362(f). We also conclude that the termination of X's S election, as a result of Agreement 2 creating a second class of stock, was inadvertent. Accordingly, under § 1362(f), X will be treated as an S corporation from Date 3, and thereafter, provided the S election for X is otherwise valid and has not terminated under § 1362(d).

Except as specifically ruled above, we express or imply no opinion concerning the federal tax consequences of the facts described above under any other provisions of the Code. Specifically, we express or imply no opinion as to whether X was otherwise eligible to be treated an S corporation.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to X's authorized representatives.

Sincerely,

*Laura C. Fields*

Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter
Copy for § 6110 purposes

cc: